IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

HOUSEHOLD FINANCE CORP.,	)	
Plaintiff/Appellant,	)	BK No. 97-41809
vs.	)	Adversary No. 98-4016
LARRY BURROUGHS and JANET BURROUGHS,	)	Civil No. 98-4291-JPG
Defendants/Appellees.	)	

MEMORANDUM & ORDER

GILBERT, Chief Judge:

Before the Court is Household Finance's ("Household") appeal of the Bankruptcy Court's award of costs and fees against it for filing unjustified adversary proceedings in the underlying matter. The issues on appeal have been fully briefed by the parties. (Docs. 2, 12). The appellees, Larry and Janet Burroughs ("the Burroughs"), have also filed a motion for attorney's fees and costs incurred defending this appeal. (Doc. 14).

I. BACKGROUND

The Burroughs filed a voluntary petition for bankruptcy relief in the United States Bankruptcy Court. Household filed a complaint challenging the dischargeability of one of the Burroughs' debts. The complaint alleged that the Burroughs had established a revolving line of credit with Household and had

taken a $1,500 cash advance on that credit 60 days prior to filing the bankruptcy petition. Household claimed that this debt was presumed to be nondischargeable according to 11 U.S.C. §523(a)(2)(C). It alleged that the Burroughs represented to Household that they had the ability and intent to repay the advance, when in fact, they did not. Household maintained that this was done with the intent and purpose of deceiving Household.

After filing the complaint, Household deposed Larry Burroughs. He testified that he had taken the advance from Household to cover living expenses while he was temporarily off work with an injury and that he intended to return to work and pay back the loan. However, after taking the advance, he learned that his injury would require surgery and that he would not be able to return to work as planned. Based on this information, Household filed a motion for voluntary dismissal of its complaint, which was granted.

At the hearing on the motion to dismiss, the Court stated that unless the complaint was substantially justified, it must grant attorney's fees and costs pursuant to 11 U.S.C. §523(d). Household stated that when it filed the complaint it knew only that the advance was taken within the statutory presumptive period. The Court found that there was no substantial

justification for filing the complaint and awarded costs and attorney's fees in the amount of $3,700.00. In the written order entered pursuant to the hearing, the Court specifically found that Household had not investigated its claims prior to filing the complaint to determine if the claims were justified.

Household filed a motion to vacate or reconsider the award of costs and fees. Household claimed that the statutory presumption of nondiscbargeability alone was substantial justification for the filing of the complaint. Moreover, Household argued, its intent to voluntarily dismiss after learning of the debtor's medical condition was a special circumstance rendering the attorney's fees award unjust. At the hearing on this motion, the Court asked what new or additional information Household had to support its request for reconsideration. Household contended that, contrary to the Court's finding, its attorney had communicated with the Burroughs' attorney before filing the complaint. The Bankruptcy Court found no reason to reconsider or vacate its order and denied the motion. Household now appeals the award of costs and fees and the denial of the motion to vacate or reconsider.

II. STANDARD

This Court, in its appellate function, upholds the Bankruptcy Court's findings of fact unless they are clearly

erroneous and reviews pure questions of law *de novo*. In re Matter of UNR Indus., Inc., 986 F.2d 207, 208 (7th Cir. 1993). However, an award of sanctions involves mixed questions of law and fact and requires a different standard of review. See Cooter & Gell v. Hartmax Corp., 110 S.Ct 2447, 2459 (1990).

In this case, the sanctions were imposed under 11 U.S.C. §523(d), which requires a determination of whether the plaintiff's position was "substantially justified." 11 U.S.C. §523(d) (West 1999). The language of §523(d) is drawn from the Equal Access to Justice Act. See 28 U.S.C. §2412(d)(1)(A) (West 1999). Appellate review is deferential under that act because a court's determination of whether a legal position is "substantially justified" depends greatly on factual determinations, which the imposing court is in a much better position to make. Pierce v. Underwood, 108 S.Ct. 2541, 2547-50 (1988). The Seventh Circuit has held that review of sanctions imposed under §523(d) should be equally deferential. In re Matter of Hingson, 954 F.2d 428, 429 (7th Cir. 1992) (citing Pierce 108 S.Ct. at 2546-49). This Court will still look carefully at whether the Bankruptcy Court's application of the law was correct. If its findings were based on erroneous views of the law, then they will be set aside. Cooter, 110 S.Ct. at 2459.

III. DISCUSSION

A. Bankruptcy Court's Orders

Household's complaint was brought pursuant to 11 U.S.C. §523(a)(2)(A) and (C), which provide that certain debts are not dischargeable upon an order of bankruptcy relief. If a creditor challenges the dischargeability of a consumer debt pursuant to these provisions and loses (i.e. the debt is discharged), the Court

> shall grant judgment in favor of the debtor for the costs to and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. §523(d) (West 1999). This provision for costs and fees was enacted to "'discourag[e] creditors from objecting to the dischargeability of consumer debts in marginal cases [because] the threat of litigation and the expenses thereof are often enough to coerce a debtor to settle or make payment in a reduced amount where otherwise the debt would ... simply be discharged.'" In re Rhode, 93 B.R. 622, 624 (Bankr. S.D. Ill. 1988).

The plaintiff has the burden of proving that proceeding with the claims is substantially justified. In re Rhodes, 93 B.R. at 624. "Substantially justified" means that the creditor has "a reasonable basis in both law and fact to ask for a determination

of dischargeability." In re Wuerffel, 1997 WL 24525, No. 96-D-20045, *I (N.D. Ill. Nov. 12, 1997). Some courts have held that attorney's fees should be imposed whenever the court finds that the plaintiff has proceeded past the point where the plaintiff knew or should have known that it could not carry its burden of proof In re Shurbier, 134 B.R. 922, 928 (Bankr. W.D. Mo. 1991) (citing Manufacturer's Hanover v. Hudgins, 72 B.R. 214, 220-21 (N.D. Ill. 1987)). If the plaintiff cannot show substantial justification, and there are no equitable circumstances that would make sanctions unjust, the court must award costs and fees-the statutory language is mandatory. See Wuerffel, 1997 WL 24525 at *1; Rhodes, 93 B.R. at 624.

In reaching its conclusion that the complaint was not substantially justified, the Bankruptcy Court found that prior to filing the complaint 1) Household did not attend the meeting of creditors pursuant to 11 U.S.C. §341 to determine if there was any foundation for the complaint; 2) Household did not conduct a Bankruptcy Rule 2004 examination of the debtor; and 3) Household did not contact the Burroughs' attorney to determine if there was any factual basis for the complaint. The Court also found that the Burroughs were not aware at the time they took the advance that they would not be able to pay back the loans. The Court concluded that, based on these findings, Household

knew or should have known that its position was not substantially justified.

Household claims that in its motion to vacate it presented evidence of communications between counsel prior to filing the complaint that contradicted the Court's findings. Even assuming that there was some pre-litigation contact between the attorneys, the Bankruptcy Court's decisions did not constitute an abuse of discretion. First, the evidence of contact between counsel was not before the Court when it first awarded costs and fees and, thus, cannot be a basis for overturning that decision.

Second, this was the only new or additional evidence that Household could produce to support vacation or reconsideration of the original order. Besides this evidence, there was nothing before the Court to suggest that Household investigated the facts of this case before filing the complaint. A number of courts, in this circuit and others, have held that the Bankruptcy Code requires a creditor to take steps prior to filing an adversary proceeding to ascertain whether the suit is substantially justified. See Wuerffel, 1997 WL 24525 at *2 (finding that §523(d) sanctions were proper because had the plaintiff attended the §341 meeting or conducted a Rule 2004 examination, it would have discovered that its complaint was unjustified); see also In re Williamson, 181 B.R. 403 (Bankr.

W.D. Miss. 1995) (finding no substantial justification for filing the complaint where creditor failed to attend §341 meeting and did not request a Rule 2004 examination); In re Grayson, 199 B.R. 397, 403 (Bank. W.D. Miss. 1996) (same).

Household contends that, based on what it knew at the time of filing, the debt in question was entitled to the presumption of nondischargeability in §523(a)(2)(C) and that this fact alone justified filing the complaint without further investigation. It argues that the Bankruptcy Court ignored this presumption and, instead, relied on facts which were not known to Household at the time of filing-in particular, that Larry Burroughs was unaware at the time of taking the advance that he would need surgery and would not be able to pay back the loan.

Section 523(a)(2)(C) creates a presumption that a debt is nondischargeable as fraudulent under §523(a)(2)(A).[1] The

[1]Section 523(a) states that a declaration of bankruptcy does not discharge debts:

> 2) for money, property, services, or an extension, renewal or refinancing of credit to the extent obtained by -
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition; ....
>
> (C) for purposes of subparagraph (A) of this paragraph, ... cash advances aggregating more than $1,075 that are

plaintiff must prove five elements to show that a claim is dischargeable under §523(a)(2)(A): 1) the debtor made false representations; 2) the representations were known to be false; 3) an intent to deceive the creditor; 4) the creditor reasonably relied on the representations; and 5) proximate cause. In re Tondreau, 117 B.R. 397, 400 (Bankr. N.D. Ind. 1989). If the creditor can show that the debt falls within §523(a)(2)(C), however, it is presumed that the debtor did not intend to repay the obligation. In re Leaird, 106 B.R. 177, 179 (Bankr. W.D. Wisc. 1989). Several courts have held that this presumption only affects the burden of proving intent under §523(a)(2)(A). See In re Fulginiti, 201 B.R. 730, 733 (Bankr. E.D. Penn. 1996) (and cases cited therein); In re Hinshaw, 199 B.R. 786, 791 (Bankr. M.D. Fla. 1995) (and cases cited therein). Once the creditor shows that the advance falls under §523(a)(2)(C), the burden of production shifts to the debtor to show that the debt was not incurred in contemplation of discharge in bankruptcy; however, the burden of persuasion to show that the debt is nondischargeable stays with the creditor throughout the

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> extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 60 days before the order for relief under this title, are presumed to be nondischargeable.

11 U.S.C. §523(a)(2) (West 1999).

proceedings. Leaird, 106 B.R. at 179 (citing S.Rep. No. 98-65, 98th Cong. 1st Sess. 58 (1983)).

First, the Burroughs contend that the §523(a)(2)(C) presumption is not applicable to this case. They claim that Household did not plead that the advance was taken on an "open end credit plan" as required by the statute; rather, the complaint alleged that the advances were taken on a "revolving line of credit." The Court declines to resolve this issue because the outcome is the same, with or, without the existence of the presumption. If the Burroughs are correct, Household's reliance on the presumption fails. However, even assuming that the presumption applies, the Court disagrees with Household's position.

Because the ultimate burden of persuasion remained with Household at all times, simply asserting the presumption without factual support for the remainder of its burden is unacceptable. First, there was evidence available to Household before the complaint was filed that the Burroughs would be able to successfully rebut the presumption if asserted. Larry Burroughs testified at his deposition that he intended to pay the loan back at the time he took the advance. This information defeats Household's claims because it shows that the debt was not fraudulently obtained in contemplation of bankruptcy. The Court

must look to whether Household knew or *should have known* this defeating information before the complaint was filed. See Manufacturer' Hanover, 72 B.R. at 220-21 (N.D. Ill. 1987). Clearly, Household could have learned this information had it attended the §341 meeting or taken a Rule 2004 examination-that is, it should have known.

Moreover, Household did not investigate the factual basis of the other elements of §523(a)(2)(A), which it maintained the burden of proving even if the presumption had been asserted and unsuccessfully rebutted. Household still had to show that the Burroughs knowingly made false representations, that Household relied on them, and that they proximately caused its loss. Household had an obligation to investigate the basis for these claims. Again, had it done so prior to filing the complaint, it would have discovered that there was no factual support. By its own admission, however, it knew only of the timing of the advance in relation to the bankruptcy petition when it filed its complaint. Household should have known that it had no basis for the remaining allegations at the time the complaint was filed. The Court finds that the Bankruptcy Court did not abuse its discretion by finding that Household's complaint was not substantially justified. The Bankruptcy Court's decision to award costs and fees based on that finding was not an abuse of

discretion; nor was the decision to deny Household's motion to vacate or reconsider that award.

B. Motion for Costs and Attorney's Fees on Appeal

The Burroughs request that this Court order Household to pay certain costs and attorney's fees incurred as a result of this appeal. The Burroughs do not cite authority for such an award of fees and costs. However, the rules of federal and bankruptcy appellate procedure give this Court discretion to award damages and costs if it finds that an appeal is frivolous. BANKR. R. APP. P. 8020 (West 1999); FED. R. APP. P38 (West 1999). Although this Court disagrees with Household's position, it does not believe that the appeal is frivolous. Nor does the Court find that §523(d) authorizes an award of appellate fees and costs merely because the Burroughs successfully defended an appeal from the Bankruptcy Court's order for fees and costs pursuant to that section. See In re Williams, 224 B.R. 523 (2nd Cir. Bankr. App. Panel 1998); see also Cooter, 110 S.Ct. 2447 (limiting Rule 11 sanctions to trial court expenses, in part because the authority to sanction for frivolous appeals in Rule 38 places a natural limit on the scope of Rule 11).

IV. CONCLUSION

Based on the above, this Court finds that the Bankruptcy Court's decisions were not abuses of its discretion. The appeal

is DENIED, and the award of costs and fees is AFFIRMED. (Doc. 0). The Burroughs' motion for attorney's fees and costs is also DENIED. (Doc. 14).

IT IS SO ORDERED.

DATED: April 26, 1999

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/s/ J. Phil Gilbert
Chief Judge